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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, PETITIONER

v.

RECTOR & DAVIDSON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above entitled cause on April 16, 1940.

OPINIONS BELOW

The unpublished memorandum opinion of the Board of Tax Appeals is printed in the record at pages 38 to 47, inclusive. The opinion of the Circuit Court of Appeals is reported in 111 F. (2d) 332.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 16, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the group associated together and doing business under the name of Rector and Davidson was, during the taxable years involved, an "association" within the meaning of Section 1111 (a) (2) of the Revenue Act of 1932 and Section 801 (a) (2) of the Revenue Act of 1934, and as such subject to income tax as a corporation during the years involved.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and regulations involved are printed in the Appendix, *infra*, pp. 14-23.

STATEMENT

Rector & Davidson, sometimes hereinafter referred to as the taxpayer, filed a Partnership Return of Income for the taxable years 1932, 1933, and 1934, disclaiming any liability for federal income tax. (R. 38, 136-150.) The Commissioner of Internal Revenue thereafter determined that during the years involved Rector & Davidson was doing business as an association within the meaning

of Sections 1111 (a) (2) of the Revenue Act of 1932 and 801 (a) (2) of the Revenue Act of 1934, and as such was subject to income tax as a corporation. He therefore asserted the deficiencies in income and excess profits taxes here in controversy (R. 12-14, 24-29, 38), and petitions for review were filed with the United States Board of Tax Appeals (R. 9-11, 14-16, 20-22, 31-34). The proceedings were submitted to the Board upon certain documentary evidence and oral testimony (R. 68-163) and the facts were summarized by the Board as follows (R. 39-46):

In February and March, 1931, four individuals, O. M. Rector, an oil operator, Robert Davidson, an insurance agent and farmer, Charles Hagins, operator of a planing mill, and J. R. Webb, engaged in the tombstone business, each purchased an undivided one-fourth interest in an oil and gas lease on $2\frac{5}{8}$ acres of land known as the Brightwell Tract in Rusk County, Texas. The cash payment for such acquisition of that lease was made with money borrowed from the First State Bank of Corsicana, Texas, on a note signed by each of those four individuals. Such lease, which was for a term of five years and as long thereafter as oil, gas, or other mineral was produced from the leased premises, was taken in the name of J. R. Webb as lessee and reserved to the lessors a $\frac{1}{8}$ th royalty and certain royalties on gas and other minerals. The lease was signed and acknowledged by the proper parties and

duly recorded in the deed records of Rusk County, Texas. (R. 39.)

Since Rector was an experienced oil operator and Davidson had some knowledge of bookkeeping, the above named four individuals decided that the lease should be transferred to O. M. Rector and Robert Davidson, who should supervise the operation of the leased premises and keep the necessary accounts. Furthermore, since those four individuals were not financially able to develop the leased premises, they also decided to sell fractional interests in the lease to the extent of $\frac{1}{5}$ th of their joint $\frac{7}{8}$ ths working interest. (R. 39-40.)

On May 18, 1931, J. R. Webb duly executed and acknowledged an assignment of the full $\frac{7}{8}$ ths interest in the above mentioned lease to O. M. Rector and Robert Davidson, their heirs, successors, and assigns, and such assignment was duly recorded. Rector, Davidson, Webb, and Hagins divided their joint interest in the lease into 360 fractional parts, each retained a $\frac{7}{360}$ th interest, and, through personal solicitation of their friends and acquaintances in Corsicana, they sold a total of $\frac{7}{360}$ ths fractional interests to 43 persons, for an undisclosed consideration for each $\frac{1}{360}$ th interest. On May 23, 1931, there was executed an assignment of an undivided fractional interest in the lease to each of the 43 purchasers of such fractional interest, and each assignment, which also embodied a power

of attorney to Rector & Davidson, was made on the following form (R. 40-44):

WHEREAS, O. M. Rector and Robert Davidson, operating as Rector and Davidson, are the owners of an oil, gas and mining lease covering the following described tract of land situated in Rusk County, Texas, to-wit:

* * * * *

NOW THEREFORE * * * the undersigned, the present owners of the said lease and all rights thereunder or incident thereto, do hereby bargain, sell, transfer, assign and convey unto ----- an undivided ----- interest in and to all of the right, title and interest of the lessee * * *.

* * * * *

1. In consideration of the grantee, herein above named, purchasing this assignment and the leasehold property herein conveyed, Rector and Davidson hereby contract and agree to do the following things, to-wit:

(a) To drill at their own cost and expense, one well on the lease above described; said well to be drilled to a depth of 3,800 feet unless granite in solid formation in its regular place is encountered at a lesser depth and in such quantities as to render it impenetrable; or unless oil or gas in paying quantities be encountered at a lesser depth.

2. In consideration for Rector and Davidson doing the things set out and stipulated in paragraph numbered "1" above and in subdivision "a" thereof, the owner and holder of this assignment agrees that Rector and

Davidson shall operate said lease above described for the benefit of all the parties interested in said lease; and shall collect for all pipe line runs of oil from said lease, and likewise, collect all money to be received from the sale of gas from said lease; and after having paid all proper operating expenses, shall distribute and pay to the owners of said lease, such proportion of the remaining proceeds as their respective interests in said lease shall entitle them to receive, according to the proportionate part of said lease they then own.

3. It is further agreed by the parties hereto that the undersigned Rector and Davidson shall have the power at any time, in their discretion, to sell and dispose of all or any part of the above described lease-hold property on such terms and conditions and at such price as in their judgment shall seem best and proper, and the said Rector and Davidson, as a part of this sale, hereby reserve the power and right to make such sale or sales of all or any part of said property, and to transfer, convey and assign the same, and as an incident thereunto, they shall execute and deliver all such written instruments as may be necessary or required to properly and legally convey and assign good title thereto, to the purchaser or purchasers thereof. And the said Rector and Davidson are, for the purpose of making such sale or sales, fully and completely authorized and empowered to sign the name of the grantee

herein to any and all instruments that may be necessary to be executed and in all other respects to act in said grantee's place and stead as said grantee's attorney in fact, executing, acting and delivering such written instruments and muniments of title the same as grantee could do if personally present and executing and delivering the same in person, and in accepting and buying this assignment, the grantee herein does so with the express understanding that the said Rector and Davidson, as above stipulated and provided, may act as attorney in fact for said grantee as above set out, the said grantee hereby ratifying and confirming all such lawful acts as the said Rector and Davidson shall do or cause to be done by virtue hereof. It is expressly understood and agreed, however, that when said leasehold property or any part thereof shall have been sold as herein provided, the said Rector and Davidson shall receive and distribute to each of the parties owning an interest in said leasehold property or any part thereof, such proportionate part of the net proceeds derived from said sale as each of said parties shall be entitled to receive, according to the interest each of the parties respectively owns in said leasehold property or part thereof. It is further agreed by and between the grantor and grantee herein that this instrument is to be effective as an assignment, transfer and conveyance of the interest

herein described only when signed and acknowledged by the grantor herein.

Rector and Davidson hereby reserve the right to pay all money due to the owner of the interest hereby assigned to the grantee herein unless they shall have received notice that the interest hereby assigned has been sold and assigned by the grantee herein to some other person. All subsequent assignees of the interest herein assigned shall take said interest subject to and be bound by the terms, covenants, agreements and reservations herein contained.

IN WITNESS WHEREOF, the undersigned owner and grantor has signed this instrument this _____ day of _____, A. D. 19_____.

RECTOR AND DAVIDSON,
By _____,
Grantors.

_____,
Grantee.

On May 1, 1933, Rector & Davidson, by written assignment duly acknowledged and executed, transferred to each J. R. Webb and Charles Hagins their 72/360ths interest in the lease. (R. 44.)

The use of the name "Rector & Davidson", as a firm or partnership name, arose out of acquisition of the leased premises by Rector, Davidson, Webb, and Hagins and their decision that Rector and Davidson should supervise the operation of the leased premises. That name of "Rector & David-

son" was not at any time used in connection with any other enterprise. The designation of "Rector and Davidson—Brightwell Lease Syndicate No. 1", appearing at the head of the assignments given to the purchasers of fractional interests, was merely for the purpose of identification of the project. In 1933 the following instrument was executed (R. 44-45):

O. M. Rector,	Instrument: Affidavit
et al	Dated: Feb. 7th, 1933
To	Filed: Feb. 9th, 1933, 11 AM
The Public	Recorded: Vol. 229, Page 577
# 843	Rusk County Deed Records.

RECTOR AND DAVIDSON, TO THE PUBLIC

This is to advise the public that the partnership of Rector and Davidson, in the Rusk County, Rector and Davidson-Brightwell Lease Syndicate No. 1 is composed of the following persons and interests at this date.

O. M. Rector, $\frac{7}{360}$ interest; Robert Davidson, $\frac{2}{360}$ interest; Harold M. Davidson, $\frac{7}{360}$ interest; J. R. Webb $\frac{7}{360}$ interest; Chas. Hagins, $\frac{7}{360}$ interest; and the remaining $\frac{7}{360}$ interest is owned in various sums and amounts by several persons by assignments on special form of assignment of oil and gas lease, said persons being known in said partnership as unit holders.

Witness our hands this 7th day of February, 1933.

O. M. RECTOR
ROBERT DAVIDSON

Rector, Davidson, Webb, and Hagins drilled and equipped the first well on the leased premises at their own expense. A second well was drilled in 1933 and paid for by *pro rata* contributions from all of the co-owners of fractional interests. The third well, which was drilled in 1934, was financed by the driller, Fred Upchurch, who, with the consent of all the fractional interest holders, was given a duly executed assignment, dated September 15, 1934, for a $\frac{1}{6}$ th interest in the entire leased premises. Thereafter, the denominator of fractional interests was changed to 432nds. (R. 45.)

During the taxable years in question O. M. Rector and Robert Davidson operated the leased premises, arranged for the sale of the oil produced therefrom, paid the expenses and distributed the net proceeds therefrom in accordance with their separate agreement with each purchaser of a fractional interest. Such operations were on behalf of all of the various co-owners of fractional interests in the leased premises. Rector supervised the operations and Davidson kept the accounts and performed various odd jobs and each of them received a salary for such services. The books of accounts, which showed the various interests owned, the oil runs, expenses, and all of the transactions with reference to the leased premises, were kept at Davidson's home. "Rector & Davidson" had no office, no seal, no minutes, and no stock books. (R. 45-46.)

All receipts from the pipe-line companies for oil purchased from the leased premises were deposited in a bank account captioned "Rector & Davidson" and the checks drawn thereon were signed "Rector & Davidson, By O. M. Rector", or, "By Robert Davidson", whichever drew the checks. Settlements were made with the interest holders every 30 days, after the payment of operating expenses which included the salaries paid to O. M. Rector and Robert Davidson. (R. 46.)

During the years in question the numerous owners of fractional interests in the leased premises were not issued any certificates or evidences of their interests other than the above mentioned assignments by Rector and Davidson in 1931 and subsequent conveyances which were made from time to time, during those years, by the individual owners of fractional interests. Such conveyances were made by duly executed assignments without the consent of other interest holders and without interrupting the operation of the leased premises by O. M. Rector and Robert Davidson. The co-owners of fractional interests never held any meetings and whenever they were consulted as to the operation of the lease, such as was done in connection with the drilling of the second and third wells, Rector and Davidson merely called on them personally. There was no limitation upon the personal liability of the various co-owners of undivided fractional interests in the lease. (R. 46.)

The Board concluded, on the basis of the foregoing statement, that Rector & Davidson was not doing business as an association during the taxable years involved within the meaning of the applicable revenue acts and that it was not taxable as a corporation. (R. 47.) The Circuit Court of Appeals affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the question whether Rector & Davidson was taxable as a corporation during the years involved is a question of fact, and in failing to hold that the question is a question of law.

2. In holding, on its assumption that the question is one of fact, that the Board of Tax Appeals found as a fact that Rector & Davidson was not an association taxable as a corporation for the years involved.

3. In holding, on its assumption that the question is one of fact, that the evidence supports the Board's finding that Rector & Davidson was not an association taxable as a corporation.

4. In failing to hold as a matter of law that Rector & Davidson was, during the years 1932, 1933, and 1934, doing business as an association as that term is used in Section 1111 (a) (2) of the Revenue Act of 1932, and Section 801 (a) (2) of the Revenue Act of 1934, and as such subject to the federal income tax imposed on corporations.

5. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

The facts and issues in this case are substantially the same as those involved in *Helvering v. Horseshoe Lease Syndicate*, in which a petition for certiorari has been filed, No. 184, 1940 Term.¹ We respectfully refer the Court to our petition in the *Horseshoe Lease Syndicate* case for a statement of the reasons for granting the writ. Obviously, if certiorari is granted in that case, it should likewise be granted here.

CONCLUSION

Wherefore, it is respectfully submitted that this petition should be granted.

FRANCIS BIDDLE,
Solicitor General.

JULY, 1940.

¹ The court below prefaced its statement of facts with the remark that "The facts in this case are very similar to the facts in *Commissioner of Internal Revenue v. Horseshoe Lease Syndicate*, decided by this court on March 26, 1940."